POST-WAR INFLATION IN INDIA – A SURVEY

BY

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FOREWORD

Some months ago the Institute published the reports of the Commodity-Prices Board. These were edited by Mr. Sovani and it was first thought that a survey of the economic situation between 1944 and 1948 should be included in the publication. Mr. Sovani wrote the survey for this purpose. However, it became, inevitably, so lengthy that it was decided to publish reports of the C. P. Board without the preliminary survey. This publication comprises, in the main, the survey prepared by Mr. Sovani. The account as well as the statistics included in the survey bring the story down to the beginning of September 1948. The statistics for only a few later months were available at the time of going to press; also, government had announced a change of policy in September which was expected to be implemented during succeeding months. It was therefore thought best to close the account at the beginning of September 1948. Some observations about the new policy of government, subsequent trends and possible results have been included in this Foreword.

The issue of this survey as an independent publication is an accident. At the same time it has long been the intention of the Institute to initiate a series of biennial or triennial surveys of economic affairs in India. It is hoped that this publication might become the first of such a series. Among various publications of the Institute the only one comparable to this in scope and intent is Publication No. 10, "War and Indian Economic Policy". The first edition of this publication was put forth in April 1943. At that time there appeared no realisation on the part of the Government of India of the seriousness of the inflationary situation and of the need for taking strong and comprehensive measures to deal with it. When, a year later, a second edition of the book was issued it was possible to report the emergence of greater understanding and some effective action. The twelve months from April 1943 to April 1944 laid the foundation of the regulatory policy of the Government of India for the rest of the period of war. There had been much improvisation during this period and a great deal yet remained to be done if the policy was to rest on secure foundations and to be built on proper lines. What then appeared to us to be necessary in these directions may be recounted in the terms of the concluding sentences of the second edition of that publication. "The situation during 1943 was for the major part still so

* A note written by me for the Reserve Bank of India at the time of the declaration of the par value of the rupee is also included in the publication. This note may throw useful light on the then facts and expectations and may help in an appreciation of the difficulties of economic judgment and of tendering advice on policy.
difficult that a general anti-inflationary direction to control was all that was perhaps possible or necessary. Today, though there has been some improvement, there is still no room for complacency; and the situation calls for a clearer definition of objectives and a more specific direction to the controls. In our opinion two immediate steps are necessary. Firstly, every attempt should be made to put a stop to any further expansion of the note issue. This could be best achieved by the direct imposition of a maximum limit on the issue. Secondly, the various aspects and instruments of economic control should centre round and be co-ordinated by a policy of comprehensive price control. The main objective of this price control should be to stabilise prices at as low a level as circumstances permit. The interests of the poor consumer, rural as well as urban, and of the small producer, agricultural as well as non-agricultural, demand this. It is also indicated as the right policy by consideration of the post-war situation, internal as well as international. The price level of agricultural produce should provide the nucleus for the plan of price control and the main determinant measure of the level of stabilization should be the All-India statutory prices of the main cereals."

The policy suggested in the above quotation was not followed by the Government of India and no material improvement on the system built up during 1943-44 was made in later war years. It may be said that the suggestion regarding fiscal and currency policy was a counsel of perfection which could not be followed in the circumstances of a desperate war. There was, however, little justification for the inaction of Government regarding coordination and integration of the system of controls and the attempt to bring down the price level. The results of the failure in these directions of the Government of India were experienced in subsequent years.

The rise in prices of agricultural and industrial goods between 1941 and 1943 was large and rapid. The rise, however, was not even in all categories. Thus among cereals, the prices of rice and wheat rose specially rapidly and their level even under control in 1943 was more than three times the pre-war level; on the other hand, controlled prices of millets were only a little higher than double of the pre-war level. Also, there was disparity in movements in controlled prices, especially of rice, which permitted a smaller increase over the pre-war level in some areas than in others. Again, a number of factors combined to keep the prices of some agricultural products, notably cotton and oilseeds, comparatively depressed for the duration of the war. Among manufactured goods, cloth prices had risen most rapidly in 1942-43; their proper control was one of the most vital problems in 1943-44. The increase in the prices of other manufactured commodities was not equally large. Among important consumers' goods the price of sugar remained low at an index of 170 of the pre-war base throughout the war. The price of iron and steel also kept low by comparison. However, prices of the most-import-
ant products of general consumption of this industry, galvanized corrugated sheets, reached more than three times their pre-war level before the beginning of 1943 and kept at this high level during subsequent years. The rapid rise of the prices of certain products during 1942-43 increased greatly the profits in some occupations and industries, the cost-price relationship in 1943-44 being highly favourable for the growers of certain products and for some manufacturers.

The relative position of prices and costs was thus far from being properly adjusted when a general system of controls was first brought into being and it was necessary for government to make the necessary adjustments as well as to determine the general level at which prices could be stabilised. If Government had been able to realise the importance of this issue and to deal with it satisfactorily the post-war situation would undoubtedly have proved easier to handle. The weakness of the Indian Government was specially apparent in two directions. It was unable to do anything in relation to the price of wheat which among agricultural products had risen the most. The price of cloth was an even more flagrant case. The prices of cotton had kept low and the profits of the cloth industry had attained extraordinary levels and yet government agreed to leave the control of these prices substantially in the hands of the industrialists themselves and acquiesced in the high margins that they continued to enjoy. The prices of other manufactured products brought under control were also negotiated prices which permitted ample margins to producers and distributors. The policy of the Government of India in this matter was in marked contrast to the policy adopted by other countries which administered a fairly efficient set of controls. In each of these the maintenance of as low a price level as possible was made the supreme aim and when any price was fixed the most meticulous scrutiny of the margin available to the producer or any intermediary was always undertaken. Except for small reductions in the prices of some controlled commodities during 1944-46 Government in India contented itself with maintaining prices at about the levels at which they were first brought under control.

It may be that Government felt that, as a large part of the profits of industry were being drained away through the income-tax, no special pains need be taken to reduce prices. In taking up this attitude government ignored the dynamic effects of the prices of industrial products on the working of the whole economic structure and was, moreover, unduly optimistic as regards its own ability to collect through income taxation the major part of the gains of the industrialists. It is obvious that the price revolution of 1942-44 changed the distribution of income in society in favour of industrialists and the growers of certain agricultural products. The classes to suffer from the change were, as always, the salaried classes, a bulk of wage earners and certain classes of agriculturists. In other countries, where controls were early imposed and
successfully administered, the indices of the cost of living were kept substantially below the indices of wholesale prices. That this was done was itself evidence of the ability of these governments to cut close the gains of all types of intermediaries and to soften the incidence of the price rise on the wage earners and the salariat, while permitting primary producers to profit as far as was safe from the situation. Also, in these countries a comparatively favourable treatment was given to the primary producer as compared with the manufacturer; this was shown by the higher increase permitted in the wholesale prices of agricultural commodities than in those of the manufactured goods. The situation in India was different in both these respects. The price level of primary products as a whole did not rise significantly higher than that of manufactured goods, and the cost of living index had risen by 1943, in most centres of Indian industry, at least as much as the general index of wholesale prices, in some it was even higher.

During the period 1943 to 1946 the economic system was subjected to pressures arising naturally out of the situation delineated above. There was pressure on the part of workers for an increase in the wage level which would compensate them in some measure for the increase in the cost of living. The demand of workers for higher wages and allowances met with success, in the different industries, after varying periods. In the important centres of cotton industry, Bombay and Ahmedabad, workers were in receipt of an allowance linked to the cost of living index from almost the beginning of the war. On the other hand, in coal mining and on the plantations the workers received almost no relief for the whole period of the war, during which the real earnings of industrial workers as a whole kept below the pre-war level. The poorer members of the salariat such as inferior government servants, police constables, primary school teachers, the bulk of the employees of the Railway, Posts and Telegraphs Departments, who felt the strain of the increase in the cost of living the most, also began to agitate during the closing years of the war for a much needed relief. The agriculturist in certain tracts developed a sense of grievance during the same period. The increase in the prices of his consumption goods had been more than threefold; on some items of his cost of production, especially livestock and its feed the increase had perhaps been even more. The prices of his products had, however, kept at a comparatively low level. In the early years the lightening of the money burden of debt and taxation and the low levels of agricultural wages had compensated him somewhat for these disparities in the movements of prices. However, as the agricultural labourer’s wage in particular began to mount up and other prices showed no signs of decrease his position appeared in a more and more unfavourable light.

Such was the situation at the end of the war. The general feeling at the time, however, anticipated an immediate slackening of activity and inflationary pressures. These expectations were falsified by actual
events. The causes of this development have been discussed in some
detail by Mr. Sovani (pp. 10-13).

In India, the year 1946 was marked by severe political disturbances
and the coming into office of a transitional Government. One of the
first steps taken by this Government was the raising of the price of
sugarcane and lifting of control on the price of jute; and the new Minister
of Industries and Supply, Mr. C. Rajgopalachariar, indicated in the Oil
seeds Conference in September, 1946, his own bias in favour of general
decontrol. The oil seeds group, at this particular time, held a crucial
position in the structure of agricultural prices. During the war, prices
of two important groups of Indian industrial raw materials (1) cotton
and (2) oil seeds had remained comparatively low. The position of
Indian cotton had depended, in the pre-war period, on demand from
other countries, especially Japan. This had vanished since 1940 and had
created a problem of surplus production which faced Indian cotton
throughout the next five years. The two main oil seeds, viz. ground nut
and linseed, had also been dependent to a considerable extent on foreign
markets during the pre-war period. These experienced a recession in
early war years. Later, the demand for oil seeds revived because of the
demand from the belligerent countries. The purchases of these goods
during later war years were, however, made in bulk. It was the
operations of the U. K. C. C. that controlled mainly the price
situation regarding many oil seeds during this time. The situation
for the season 1945-46 was substantially different on account
of the end of war. Therefore, in this year, Government brought
oil seeds under formal control and evolved a basic plan for
them for the whole of the country on lines of the basic plan for food-
grains. It was at the Conference convened to consider the formation
of the basic plan for oil seeds for 1946-47 that the policy of general
decontrol was foreshadowed by the Minister of Industries and Supply of
the new Government. The plea for decontrol was not immediately
accepted; but the basic plan for 1946-47 could not take shape during
the season and control over oil seeds was ultimately given up in March
1947.

That 1946 marks a turning point in events and expectations
is shown by another significant fact. It has been indicated above
that the prices of manufactured goods in India during war-time were
negotiated prices. No effort was made by the Government of India to
put the pricing of these products on a uniform basis or to exercise the
necessary constant downward pressure on them. However, desultory
attempts were made by individual departments concerned to scale down
prices of individual products and they met with some success up to
the year 1946. The readiness of the industrialists to accept a reduction in
prices under control is a fair indication of both the facts of business and
the prevailing psychology of businessmen. The iron and steel industry
offered a reduction in the prices of its products as late as January, 1947. The attitude of the Tata Iron and Steel Co. in regard to prices may be said to have stiffened only between January 1947 and March 1947. Similar changes for the other industries may be said to have taken place from about one quarter to three quarters of a year earlier. The last reductions accepted by the main industries whose prices were under control were as follows:—for cloth, for the first quarter of 1946; for paper, for the second quarter of 1946; for cement, for the second quarter of 1946; and for iron and steel, for the third quarter of 1946.

In the situation as it had developed by the end of 1946 it was possible for Government to move in one of two directions. It could take steps to rectify the mistakes of the older Government and to integrate and rationalise controls or it could go on gradually or speedily to decontrol. That the former possibility was fully open was illustrated by the appointment of the Commodity Prices Board and the reports presented by that body to Government. In spite of the initial trend, as indicated by action in respect of sugar and jute and by the wavering on the oil seeds question, or perhaps because of the apprehensions raised by these steps in the minds of some of the members of Government, the Commodity Prices Board was set up in February, 1947. It was specifically charged to bring and keep in line the prices of various commodities. The attempt to coordinate controls and regulate prices might have been much more easy and successful if machinery for that purpose had been set up and the lines of policy firmly laid down during the war. However, the position had not worsened beyond repair, in the first quarter of 1947. The reports of the Commodity Prices Board give detailed account of the manner in which it could have been brought under control and gradually improved.

It is now clear that it was political forces rather than economic that made impossible the fruition of the work begun in this direction. The interim Government of 1946–47 was a composite one in which two opposite forces were represented: one in favour of private enterprise and of giving Indian capitalists full opportunities and the other with a bias against Indian capitalists and, therefore, tending towards a programme of socialisation and high taxation of business and industry. The programme of action visualised by the Commodity Prices Board did not necessarily mean adoption of either one or the other extreme. It was a middle of the line programme which, while it refused to allow the capitalist to reap undue profits from the critical economic situation in the country, would not have necessarily meant the extinction of private enterprise or even any large step in the direction of socialisation of industry. As it happened, however, the only support that the work of the Commodity Prices Board, had was from the anti-Indian-capitalist group, with the possible result that the pro-capitalist group felt it necessary to nullify or make impossible the work
of the Board. Thus while the Finance Department would support the policy put forward by the Board, the Industries and the Supply Department could effectively sabotage it.

The reduction to impotence of the Commodity Prices Board synchronized with the appointment of a new instrument of policy-making, the 'Foodgrains Policy Committee.' With the appointment of this Committee it was clear to the well informed that plans for complete decontrol had been well and securely laid. The manner in which the work of this Committee was conducted, its recommendations presented and implemented showed the forces that were now in control and would also control future Indian economic policy. With the partition of the country the one political group that had shown itself capable of withstanding pressure of Indian capitalists had vanished from the scene. Henceforth, it was only a matter of convenience and appropriate opportunity, with what formalities and in what stages the changes were made.

The campaign for decontrol, of which the Foodgrains Policy Committee was the spearhead, gathered momentum with the presentation of the interim recommendations of the Committee (November 1947) and achieved rapid success soon after. The Government of the new state, the Indian Union, seemed to adopt, with the adoption of the policy of decontrol, 'the definite aim of liquidating Government commitments as early as possible' as the first principle of its economic policy. Food controls were the first to go and sugar was decontrolled almost immediately afterwards. Decontrol of cloth and yarn had not to wait for many months and the prevailing sentiment was indicated by the very liberal increases given in the controlled prices of Iron and Steel in January, 1948. Decontrol directly affected the prices of essential consumer goods and through them the indices of the cost of living. Its greatest effects are, therefore, to be observed in the differences, as for November, 1947 and July, 1948, between the indices for prices of cereal foodgrains, cotton manufactures and sugar and for the cost of living in centres like Kanpur.

The failure of the policy of decontrol followed inevitably on the failure of the new policy regarding the supply and prices of foodgrains. The whole thesis of the Foodgrains Policy Committee rested on the supposition that there were enough stocks of grain in the country which decontrol would bring forth and that even a moderate price rise would bring about automatically appropriate adjustments in supply and distribution. It was expected by the Committee that the price rise under decontrol could never be so high as to upset operations of Governments who still undertook certain responsibilities of controlled and rationed distribution. The aftermath showed how weak the foundations of the recommendations of this Committee were. The Bombay Government has been blamed by some of the supporters of the Foodgrains Policy Committee because of its so called rapid decontrol. However, the Foodgrains Policy Committee had itself insisted on individual Provincial
Governments reducing their commitments to a minimum as early as possible. The commitments of the Bombay Government on behalf of the industrial cities were large and were responsible for almost a half of its total commitments under a fully rationed system. Procurement by Government under its compulsory levy scheme was impossible with the large increase of market prices. The quota of imports that the Foodgrains Policy Committee had arbitrarily allowed to the Bombay Government did not suffice for the needs even of the industrial cities. Any substantial increase of prices in the industrial cities was a matter of general concern because in Bombay and Ahmedabad the dearness allowance was linked, especially in case of textile labour, to the cost of living and a sharp increase in the price of food might have immediately affected the price of cloth. The Bombay Government was thus forced to conserve the import quota fixed for it by the Government of India for feeding the population of rationed cities and to decontrol all the other areas in obedience to the behest of the Government of India. The difficulties of the Government of Bombay were the difficulties of deficit provinces. The plight of the surplus provinces illustrates another aspect of the basis of the assumptions of the Foodgrains Policy Committee. For example, the Central Provinces had always been a surplus area and had supplied other provinces with substantial quantities of grain under the basic plan. As might have been expected, and had in fact been pointed out by the writers of the minute of dissent, the surpluses in Central Provinces vanished on decontrol. Not only did the overall surpluses dwindle but also the surplus provinces were not able to contain the urge towards price increase loosened by decontrol. Even with stringent bans on provincial movements, prices in the U. P. and C. P. moved rapidly upwards. The continuance of rationing in some cities protected the cost of living index in those cities. Elsewhere, however, these indices rose rapidly. The disparity is reflected in the different relative movements in the cost of living indices for, say, Bombay and Kanpur.

The Foodgrains Policy Committee also felt that, however urgent the need to feed the people of the country through imports, the financial resources of the country could not permit of continuance of large imports of foodgrains indefinitely. Therefore, it recommended a maximum target for food imports which should, in no circumstances, be exceeded. The sequel to the adoption of its policy showed, on the one hand, that the Committee had exaggerated the effects of control on the availability of food grains and, on the other, that a rigid limit on imports was unworkable.

During the first half of 1948 price incentive to bring all the supply of foodgrains into the market was abundant; even so the prices, instead of being checked by overabundant supply, continued steadily on the increase. It is not possible to assess the extent of supplies, formerly hidden, which might have now come forward. They were obviously not ample
enough to dampen the market; and throughout the season traders continued to buy up new arrivals in the market at higher and higher prices confident of reaping considerable profit in months after new supply had ceased coming to the market. These expectations of traders were not defeated, and after May, 1948 prices remained on an average at a much higher level than that during the preceding months. Among the provinces which were deemed surplus provinces decontrol had meant a large diminution or an entire extinction of the stock of foodgrains over which Government had control. The only way to act on prices or to relieve in some measure the distress of the classes most affected by rising prices was through controlled distribution of foodgrains in particular areas or to particular classes at specified prices. The only source of obtaining supplies of food grains for the purpose left to Government, after it had thrown over the systems built up through war time, was imports of food grains from abroad. In the face of the serious situation the Government of India did not rigidly adhere to the recommendations of the Foodgrains Policy Committee to impose a maximum limit on the imports of food. Government could not either be callous enough or be careless enough of their own future to maintain the maximum limit on imports at the cost of starvation of large classes of people. Imports had, therefore, to be brought in, in much larger quantities than had been necessary in any previous year and the situation was partially stabilised through their aid.

It is no matter of surprise that imports were large after decontrol. With comparatively developed systems of procurement and rationing, prices are kept under control and equitable distribution brought about with minimum supplies. The more successful are procurement activities and more detailed the rationing, the more do needed imports approximate to the actual net deficit in internal supplies. The abolition of rationed distribution meant that in case Government desired to affect prices of foodgrains it had to do so in competition with private sources of supply. Government would have, for the purpose, to offer grain at all strategic points, in adequate quantities. It could not eliminate, as under rationing, the pressure of the demand of the richer consumers or of the speculative hoarders; neither could it, by compelling consumers as under rationing to buy what it had to offer, abolish or narrow differentials for preferred supplies. Government, acting through only their imported supply, could not equally control all prices and could give relief to special classes only through making available to them supplies of cheap imported grain which they would buy only because the internal supplies were priced very high. In a number of instances the supply of even cheap grain had to be heavily subsidized to make it at what appeared to Government a fair price.

The inflation of currency during war time, which was at the root of most problems of the post-war period, was brought about by large
Government deficits on either their own account or on account of the H. M. G. and other allied governments. This deficit-financing persisted for some months even after the end of the war and further increased the inflationary pressure and potential. The rise of prices till about the middle of 1943 was the result of an open inflationary movement. The rise was slowed in the second quarter of 1943 and from about the middle of 1943 to the end of the war the level of prices did not, as a whole, rise. These prices were kept under check chiefly through a detailed system of controls. During the same period, however, the currency in the country, nearly doubled itself. This together with the changes in the cost-price relations referred to above made the working of the system of controls more and more difficult. After the opening months of 1946 the pressure of currency on prices was not allowed to increase for almost a year and a half. The apparently large fall in Government expenditure during 1946–47 was achieved chiefly by reclassification of expenditure and there was little decrease in the total outlay of the Government of India during 1946–47 from the high level reached in war years. However, during this year Government budgeting, though it did not in any way relieve the pressure on prices through the creation of a revenue surplus, did not at least make it more difficult by adding to the currency for financing a deficit. The situation, however, worsened after the partition. This was partly because the many unforeseen expenditures that the Indian Union had to undertake after August 1947 could not be met completely from current revenues and also because the new Finance Minister, in planning revenue receipts and remissions, was evidently misled by the distinction between revenue and capital expenditure and did not give sufficient attention to the potential inflationary effect of his deficits on capital account. The period between the middle of 1943 and the end of 1947 may be called the period of suppressed inflation. This suppressed inflation was converted into an open inflation by the policy of decontrol of prices of consumer goods adopted towards the end of 1947. The policy of decontrol synchronized with the time of mounting government expenditure and helped in its turn to increase government deficits. The additions to currency which resulted from the need of financing this additional expenditure may have given further impetus to the rise of prices in this open inflationary period, though the higher prices could have been sustained by the supply of money in existence even before the new additions.

The large increase of prices that took place between November 1947 and July 1948 created grave discontent within the country and compelled Government to reconsider its policy. Hurried consultations with representatives of industry and labour and with economists and other experts were held during August and September and an announcement of change of policy was made in the first week of October. The main features of this policy were the reimposition of food controls, the
recontrol of the prices of essential consumer goods like cloth and sugar, the decision to close the gap between revenue and expenditure, the encouragement of industrial production by tax and other concessions, the limitation of dividends of companies and encouragement to small savings. The high level reached by prices in July 1948 and the continuous increase in prices were alarming facts and the change of policy was intended primarily to check the increase and to bring prices down. Government announcement of October 1948 included the following statement. "When the revised policy comes into full operation there should be a marked decline in the present level of prices". It happened that the rise of prices was actually stayed after September, 1948. Government spokesmen have expressed the view that the change of policy had succeeded in its aim. The aim itself was declared by the Finance Minister in December, 1948 as no more than an immediate stabilisation of the price level.

It is necessary to examine the various aspects of Government policy to see how far they affect the situation immediately and promise to give lasting results. The halting of the process of increase in prices appears to have been due in some measure to the announcement of the change of policy by Government. It is, no doubt, true that the process of increase in the prices of foodgrains would, any way, have slackened in September with the prospect of the new crop and that the prices of sugar and cloth had reached peak levels already. Even so, government announcements influenced the psychology of the public and traders and helped to confirm the trend towards temporary stabilisation. In relation to cloth and sugar the fixation of controlled or agreed prices at levels somewhat lower than the earlier peaks was also helpful in stabilising price indices. There is also no immediate danger of these prices again moving upwards rapidly. During October to April new supplies of foodgrains arrive in the markets and this leads always to keep prices in check. Prices of foodgrains may be expected to remain stable till April; their future course is, however, not certain.

The decision taken to reimpose food controls was merely to the effect that the system of controls abolished in December, 1947, should be fully brought into operation by October, 1949. The steps by which the gradual imposition would be brought about were not made clear. It is only in the two deficit provinces, Bombay and Madras, where complete decontrol had after all been not found possible, that reimposition of controls has been rapid or systematic. Elsewhere the position is obscure. The procurement operations in many of the surplus provinces do not appear to be making much headway. The marketing of the harvests of the agricultural season 1948-49 should come at an end by May, 1949. If by that time no attempts have been made to procure a large proportion of the new supplies of grain by Government, these supplies will pass inevitably into the hands of the trading community. When this
happens it is difficult to see how Government will be able to control movements towards a rise in the price of foodgrains.

The prices of foodgrains hold a strategic position in the structure of price levels in India; if they are not successfully restrained, the holding down temporarily of the prices of cloth and sugar will not have much effect. How far will the other aspects of Government policy help in keeping food and related prices down? The increase of prices in 1948 cut largely into the increased money incomes that wage earners and the salariat had been able to obtain in 1947. This fact would, of itself, help the stabilisation of prices by relieving the effective pressure of the increased money incomes on the market. On the other hand, the wage earners and the salariat had now a legitimate grievance that their standard of living had again been substantially lowered. They could be persuaded to wait for some time before demanding a fresh increase of salaries and allowances only in the hope that the change of government policy would bring prices back to levels of at least 1947. This has not happened and Government seems to be going back on its decision to attempt to lower prices. Therefore, with prices stabilised at the level of 1948, demands for increases in money incomes are being pressed and in many instances the increases have already been obtained. A general increase in the money incomes of wage earners and the salariat will help to sustain another movement of price increases if it gets started.

The tax concessions given to industry by Government have little importance as an immediate anti-inflationary factor. The volume of extra production brought about by these means will not be available immediately in sufficient volume to set in motion any general movement of prices. The concessions have, however, a significance as part of the general trend of official policy. The announcement regarding industrial policy made by Government in April 1948 contained the following statement. "The system of taxation will be reviewed and readjusted where necessary to encourage saving and productive investment and to prevent undue concentration of wealth in a small section of people." Taxation as an instrument of combating concentration of wealth cannot be successful in India because of the high degree of such concentration and of the general practice of tax evasion. However, even if the instrument had been efficacious, government seems to have definitely decided not to use it for the purpose. Government has been so impressed by the need to stimulate industrial production and investment that it is now following the policy of encouraging high industrial prices and lowering the taxation on higher personal incomes and on business profits. The trend has been consistent in this direction since the first budget of the Indian Union and is marked also in the latest budget. A counterpart of this is the higher levels of indirect taxation. It is not clear that the relief given to higher personal incomes and business profits will necessarily be anti-inflationary. Not all the extra incomes left to the rich will be
saved; to the extent that they lead to increased consumption the effect will be inflationary. Similarly the outlay through additional business investment will be anti-inflationary only if it brings about an immediate increase in the supply of consumable goods. On the other hand, increased indirect taxation should increase the pressure of the demand for increased money incomes by wage earners and others.

Finally, there remains to be considered the assurance regarding the balancing of budgets. The latest performance in this respect has been highly disappointing. The budgets of many provinces are deficit budgets or budgets balanced only with increased indirect taxation. The Central revenue budget shows the dual feature of lowered direct taxation and increased indirect taxation. The most alarming phenomenon is, however, the large uncovered gap for 1948–49 revealed by the Central budget together with the proposal for another deficit for 1949–50. That these deficits are shown in the capital budget modifies the situation in no way. Mr. Sovani’s discussion of this point appears to have been specially called for in view of the budget for 1949–50 and its defence by the Finance Minister of the Government of India. It is not clear how these deficits will be immediately covered. Whatever the means chosen for the purpose their ultimate effect must necessarily be inflationary.

To conclude, neither the control, nor the taxation nor the budgetary policy of Government is such as to inspire confidence and the budgetary deficit of the Central Government seem bound to make for another inflationary movement in the future. The immediate prospect depends on the ability of Government to restrain an increase in food prices after April–May, 1949 and the ability of Government and of employers in general to resist the pressure for increasing wages, salaries and allowances. If Government is unsuccessful in these two directions it will not be able, as indicated by its record so far, to hold down industrial prices either. There is little in the internal situation to lead to the expectation that stabilization of internal prices has been or will be definitely attained. The chief hope of succeeding immediately even in stabilising prices seems to lie in the direction of international forces. If a recession in the prices of primary products takes place abroad, especially in the U. S. A., the pressure on our foodgrains and oil seeds and cotton prices may be diminished. An extension of the downward trend of prices to industrial products may also lead to resistance on the part of employers to demands for increase in wages which might prove successful if increasing unemployment emerges because of actual or potential recession. Prices may then remain stable or fall not because of increased productive activity but because of a curtailment of employment. Such a turn of events, which is not entirely to be discounted, will of course not solve the economic problem but merely change its aspects. Government, with its present administrative complement and its present frame of mind, will be even more
powerless in the face of a threat of depression than it has been in dealing with inflation. A significant fall in the prices of primary products may lead to an agricultural depression and to an early loss of the gains in relation to indebtedness, etc., made by peasants during recent years. The policy of the limitation of government commitments could, in the event, be successfully pursued. In such a situation the controls over industrial prices may still be retained but then they will be used, as before, to protect the profits of the trading and the industrial classes.

5 March 1949.
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